# INDEX



## CITATIONS





282320—41

# In the Supreme Court of the United States

OCTOBER TERM, 1940

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No. 486

MADELEINE D. POWERS, PETITIONER

*v.*

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

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*ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIRST CIRCUIT*

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## BRIEF FOR THE RESPONDENT

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### OPINIONS BELOW

The memorandum opinion of the United States Board of Tax Appeals (R. 15–19) is unreported. The opinion of the United States Circuit Court of Appeals for the First Circuit (R. 41–48) is not yet reported.

### JURISDICTION

The judgment of the United States Circuit Court of Appeals was entered July 16, 1940 (R. 48). The petition for a writ of certiorari was filed on October 7, 1940, and was granted on November 12, 1940. The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

## QUESTION PRESENTED

Where single-premium policies of life insurance are irrevocably assigned shortly after issuance, is the value thereof for gift tax purposes the cost to the donor or the cash surrender value of the policies?

## STATUTES AND REGULATIONS INVOLVED

The applicable provisions of the statutes and regulations appear in the Appendix to the Government's brief in *Guggenheim* v. *Rasquin,* No. 92, to be argued immediately preceding the present case.

## STATEMENT

The pertinent facts as found by the Board of Tax Appeals are as follows (R. 16–19):

During the period from November 25, to December 5, 1935, inclusive, Madeleine D. Powers, the taxpayer here, purchased six single-premium policies of insurance as follows (R. 16):

| Company and policy number | Date of issue of policy | Name of insured | Face amount of policy | Amount of single premium paid |
|---|---|---|---|---|
| The Fidelity Mutual Life Ins. Co. No. 532838. | 11/25/35 | Madeleine D. Powers | $20,000 | $13,967.40 |
| The Prudential Ins. Co. of America No. 9114410. | 12/ 4/35 | Madeleine D. Powers | 100,000 | 68,779.00 |
| The Mutual Life Ins. Co. of N. Y. No. 5090777. | 11/25/35 | Madeleine D. Powers | 40,000 | 27,204.80 |
| The Prudential Ins. Co. of America No. 9114963. | 12/ 5/35 | Madeleine Powers | 122,000 | 99,672.78 |
| The Connecticut Mutual Life Ins. Co. No. 887777. | 11/27/35 | Madeleine Powers | 28,000 | 22,671.60 |
| Home Life Ins. Co. No. 435395 | 11/27/35 | Madeleine Powers | 50,000 | 40,854.00 |

At the end of December 1935, the taxpayer made gifts of these policies which then had a cash surrender value and reserve carried against them as follows (R. 17):

| Company and policy number | Date of gift | Cash surrender value on date of gift | Reserve carried by Ins. Co. at date of gift |
|---|---|---|---|
| The Fidelity Mutual Life Ins. Co., No. 532838 | 12/30/35 | $12,360.00 | $12,672.02 |
| The Prudential Ins. Co. of America, No. 9114410 | 12/30/35 | 56,198.86 | 60,917.84 |
| The Mutual Life Ins. Co. of N. Y., No. 5090777 | 12/30/35 | * 23,271.30 | 25,344.05 |
| The Prudential Ins. Co. of America, No. 9114963 | 12/30/35 | 84,067.70 | 89,383.33 |
| The Connecticut Mutual Life Ins. Co., No. 887777 | 12/30/35 | 20,790.73 | 21,126.73 |
| Home Life Ins. Co., No. 435395 | 12/31/35 | 36,671.71 | 37,728.33 |

* Cash surrender value when right to surrender first arose, discounted to date of gift.

The policies in which taxpayer was named as the insured were payable at the outset to taxpayer's husband, George H. Powers, if living, and the policies in which her daughter, Madeleine Powers, was named as the insured were payable to taxpayer if living, otherwise to the insured, the estate of the insured, or the estate of taxpayer. Taxpayer retained the right to change the beneficiaries of the policies in which she was named as the insured. The gifts were in the form of irrevocable assignments to taxpayer's husband and the Massachusetts Hospital Life Insurance Company, as trustees (R. 17).

During the period from November 25 to December 31, 1935, there was not a sufficient change in the age of the insured in any of the policies to require, for the issuance of like policies during that period, the payment of larger single premiums than those

paid by the taxpayer. At the respective dates of gift there were no accumulated dividends apportioned or credited to any of the policies, provisionally or otherwise, and no paid-up additions to the policies (R. 17).

In the case of a single premium policy, the cash surrender value during the first year in which the policy is outstanding is always less than the reserve. The cash surrender value is the reserve for the policy less a surrender charge, and varies with the different companies and policy years. The surrender charge and premiums actually paid in the particular year account for the difference between the reserve and cash surrender value on a particular policy. The discouragement of surrenders is one of the reasons for the surrender charge. Part of the surrender charge is placed in a contingency reserve to meet adverse mortality and interest expense over a period of years (R. 17–18).

The premium exceeds the reserve at the outset by the amount of expenses which include commissions, taxes, medical fees, cost of issuing the policy and placing it on the books, and the inspection fee (R. 18).

With respect to Prudential Policy No. 9114410, interpolating between the initial reserve of $60,833 for $100,000 of insurance at the age of 57 and $62,024, the terminal reserve at the age of 58, the total interpolated reserve as of December 30, 1935, 26 days after the issuance of the policy, was

$60,917.84. The single premium charged at the outset, $68,779, included the amount necessary to maintain the company's reserves, plus all costs of management and commissions, commonly called loading charges. On the date of gift, none of the companies in this case would have paid to the owner of the policy the amount of the reserve against the policy. The Prudential Insurance Company of America, not having an absolute obligation to pay the cash surrender value during the first year, would have granted the discounted value of the first year cash surrender value, as of the date of the gift. Discounting the cash surrender value at 3½%, the amount in the case of Prudential Policy No. 9114410 would be $56,076.94 on the date of gift (R. 18).

On March 11, 1936, taxpayer filed with the Collector of Internal Revenue, at Boston, Massachusetts, a federal gift tax return for the calendar year 1935, valuing the gifts when made in 1935 as $233,360.30, which was the cash surrender value at the time (R. 19).

The Commissioner increased the value of the gifts to $273,149.58 by using the total amount of the single premiums paid by the taxpayer. The Board of Tax Appeals held that the cash surrender value should be used and decided that there was no deficiency in gift tax for 1935 (R. 19). The Circuit Court of Appeals reversed (R. 41–48).

## ARGUMENT

This case involves substantially the same question as is presented in *Guggenheim* v. *Rasquin,* No. 92, and we respectfully refer the Court to our brief in that case for a full discussion of the issues involved. However, the petitioner's brief herein makes three points which we will discuss briefly.

### I

Petitioner contends that the standard of value to be applied under the gift-tax statute is fair market value. In the case of property for which a real market exists we agree that the market price is a satisfactory test of the value. But where, as here, there is no real market, we submit that some other test of value must be found.

The price fixed in a real market furnishes a satisfactory test of value because it evidences an agreement "between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell." Article 19, Treasury Regulations 79 (1933 and 1936 Editions). In such a market there is an opportunity for both buyers and sellers to appraise current conditions, and their divergent views with respect to present conditions and future prospects are reflected in the price agreed upon. We completely disagree with petitioner's theory that the insurance company represents such a market.

The amount which can be realized on an insurance policy when surrendered to the issuing company has been fixed in advance. Therefore the price is not affected by the current situation at the time of the transaction, and there is no opportunity for anyone to exercise his judgment.[1] The cancellation of an insurance policy under such circumstances furnishes no criterion of the "relative intensity of the social desire for it at that time * * * ." *Ithaca Trust Co.* v. *United States,* 279 U. S. 151, 155.

Moreover, the cancellation of an insurance policy is no more a sale than was the retirement of the bonds considered by this Court in *Fairbanks* v. *United States,* 306 U. S. 436. It is merely a surrender of the policy at a price fixed in advance by the insurance company. It is not a price which is available to both buyers and "sellers," because the insurance company has one price for the "seller" and a different price for the buyers. Since the transaction is not a sale and the insurance company does not represent a real market, we submit that the cash-surrender value is not a satisfactory test of value. This Court has so held. *Lucas* v. *Alexander,* 279 U. S. 573.

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[1] Petitioner in the *Guggenheim* case agrees (Br. 21) that the cash surrender value "is not the result of the interplay of supply and demand, but of a mathematical computation of the then present value of the policy by the insurer, who, by its contract, binds itself to pay the face amount."

Where the amount available in a recognized market is used as representative of value the price is the same whether the taxpayer be a buyer or a seller. While he can sell at the market price, he can also buy at the same price. Accordingly, while the market price represents the amount which he could secure upon a sale, it represents also the amount which he would be required to pay to duplicate the property. If, as petitioner contends, the insurance company represents the market, we submit that its buying price (cash-surrender value) is no better indication of the value of these policies than is the same company's selling price (the cost of duplicating the policies). If the question of value is approached from the standpoint of the investment which the donee would be required to make in order to secure at his own expense property identical with the gift, it is clear that in this case the gift has saved the donee the expenditure of the precise amount which the Commissioner has used as the value. The cost of duplication is no novel concept of value because, as stated above, the price quoted in a real market is the exact amount which the taxpayer would be required to pay if he were a buyer instead of a seller. Accordingly, we submit that petitioner's argument that the insurance company represents a market proves too much, for the insurance company is the source of the Commissioner's determination of the cost of duplication, and the transaction from which it is derived is a sale, not a cancellation.

## II

We do not contend, as suggested by petitioner, for the relevancy of any special advantages conferred by the property which are important only to the particular owner. We have not suggested that the policies have any attributes which are important to the donor but not to the donee. We are not dealing here with family portraits, nor with shares of stock which enable the donor to control a particular corporation. We are dealing with insurance contracts which have investment value in addition to affording insurance protection. The donees are presumably interested in both.

## III

In the sense that "value" represents the dollars-and-cents result procured from the application of a formula, we do not doubt that a question of fact is presented. But where, as here, the question presented is the proper method of measuring the value, we think it is clearly a question of law. Until the method is agreed upon, the basis for ascertaining the fact is in doubt. The proper method to be applied in determining the value of insurance policies was the question presented in *Lucas* v. *Alexander, supra,* and it was treated as a question of law. Here it was agreed (R. 25) that "the only question in controversy is as to the proper method of arriving at the values to be used as the measure of the gift tax with reference to a gift of certain life insurance policies." We think it is apparent that

where the question to be resolved is the proper method of valuation, the question is one of law.

It cannot be gainsaid that the word "value" is susceptible of diverse meanings and that there is no fixed general rule of law which determines the value of property. In view of the indefiniteness of the statute we think it was proper for the Treasury to promulgate regulations prescribing the method to be used for this peculiar type of property and that the only question here is whether the regulations which have been promulgated prescribe a permissible method of valuation.[2]

For the reasons stated above, there is no merit in petitioner's final contention that the Circuit Court of Appeals has erroneously reversed the Board of Tax Appeals upon a pure question of fact. The Board held (R. 19) that "the cash surrender value is to be used as the value of the gift." The Circuit Court of Appeals did not disagree merely with the figures obtained by the use of the cash surrender value. It decided that a different method should be used for determining the value. This was clearly within the competency of the Circuit Court

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[2] In *United States* v. *Ryerson*, 114 F. (2d) 150, 152–153, now pending in this Court on a writ of certiorari, No. 494, present Term, the Seventh Circuit said: "We are of the opinion that, for purposes of evaluating a fully paid life insurance policy, the common test of 'the fair market price or value' has no significance. In view of the peculiar type of property involved, the problem for the Commissioner was to devise a fair and appropriate measure of value which reasonably could be considered the amount of the gift."

of Appeals, and the contention that the court lacked authority to determine whether or not the Board had employed a correct method is without substance.

## CONCLUSION

The decision of the court below is correct and should be affirmed.

Respectfully submitted.

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JANUARY 1941.

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# SUPREME COURT OF THE UNITED STATES.

No. 486.—October Term, 1940.

| | |
|---|---|
| Madeleine D. Powers, Petitioner, *vs.* Commissioner of Internal Revenue. | On Writ of Certiorari to the United States Circuit Court of Appeals for the First Circuit. |

[February 3, 1941.]

Mr. Justice Douglas delivered the opinion of the Court.

The issue in this case is the same as that in *Guggenheim* v. *Rasquin,* No. 92, decided this day. Petitioner in November and December, 1935, purchased single-premium policies of insurance on her own life and late in December, 1935, irrevocably assigned them as gifts. The Commissioner determined a deficiency, claiming that the value of the policies for gift-tax purposes was the cost of duplicating them at the dates of the gifts, not the cash-surrender value as reported by petitioner. The Board of Tax Appeals held that the value of the gifts was their cash-surrender value. The Circuit Court of Appeals reversed. 115 F. (2d) 209. That judgment must be affirmed on the authority of *Guggenheim* v. *Rasquin, supra,* unless as claimed by petitioner the court below was precluded from substituting its judgment of value for that of the Board. *Helvering* v. *Rankin,* 295 U. S. 123, 131. But the question of what criterion should be employed for determining the "value" of the gifts is a question of law. See *Lucas* v. *Alexander,* 279 U. S. 573. Accordingly, the Circuit Court of Appeals was justified in reversing the decision of the Board as "not in accordance with law". Int. Rev. Code 1939, § 1141(c)(1); 53 Stat. 164.

*Affirmed.*

A true copy.

Test:

*Clerk, Supreme Court, U. S.*